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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY
FOR A HEARING TO DETERMINE THE
FAIR VALUE OF THE UTILITY PROPERTY
OF THE COMPANY FOR RATEMAKING
PURPOSES, TO FIX A JUST AND
REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP
SUCH RETURN

DOCKET NO. E-01345A-08-0172

INITIAL POST-HEARING BRIEF
OF ARIZONA PUBLIC SERVICE COMPANY

(OCTOBER 3, 2008)

Arizona Corporation Commission

DOCKETED

OCT -3 2008


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INTRODUCTION AND SUMMARY

The case presented in Arizona Public Service Company's ("APS" or "Company") Motion for an Interim Rate Surcharge, in many ways, is about far more than interim rate relief. It is a threshold case about the long-term energy future of Arizona – a future that should allow for options in how power is generated, delivered and used by APS customers. The Arizona Corporation Commission ("Commission") and APS both have taken important steps over the past decade to implement policies intended to foster such a future, for example, by accommodating more timely recovery of fuel and purchased power costs by APS, by focusing on the importance of investment in renewable and other sustainable resources, by investing in demand-side management programming, and by developing new time-of-use and other innovative rates designed to influence customers' energy usage.

A healthy, financially strong utility is critical to successfully and affordably implement these important policy goals for our State's energy future. The financial strength of APS, Arizona's largest electric utility serving a growing customer base that now exceeds one million Arizona residents, is particularly critical to ensuring that our State maintains a viable energy future and that the Company's and Commission's vision for that future can be implemented in the years to come. Yet, this is a time of financial crisis for APS. The Company is one of only a few utilities nationwide with borderline investment-grade credit ratings (just one step away from junk) – a condition that Staff witness Ralph Smith concedes to be a "continual problem," and one that "the Commission should be concerned about." See Smith Testimony at 688:24-689:6.¹ Staff witness David Parcell concurred, testifying that "you want to be as far away from junk as you can be," and that he would prefer that APS's credit

¹ APS will cite to hearing testimony using this format. In the example cited, the testimony begins on page 688 of the transcript at line 24 and extends to page 689 at line 6.

1 ratings be “BBB solid” or “BBB medium,” rather than “BBB minus.” *See* Parcell
2 Testimony at 979:17-980:7. In fact, witnesses for virtually every party testified that
3 APS’s currently weak credit ratings are not in the long-term best interests of
4 customers. *See, e.g., id.* at 979:17-980:7; Ahearn Testimony at 1063:22-1064:4;
5 Higgins Testimony at 236:1-24, 237:4-16; Cicchetti Testimony at 806:24-807:6,
6 810:25-811:16, 883:20-884:2.

7 Importantly, none of the parties to this matter dispute the fact that APS faces
8 significant financial challenges, including high capital-expenditure requirements, an
9 inflationary cost environment, foreign currency pressures, an earnings shortfall, and
10 weak credit ratings hovering just above junk-bond status. Similarly, the parties
11 recognize that, absent interim rate relief, APS’s key financial metrics are at risk of
12 falling below the levels necessary to sustain its ratings within investment grade before
13 the close of the general rate case, and that APS is at risk of being further downgraded.
14 *See, e.g.,* Ahearn Testimony at 1064:25-1065:2; Smith Testimony at 630:2-10 (“I do
15 understand the concept of risk. And with the company’s bond ratings where they are,
16 I do think there’s some risk. There’s some risk that some unforeseen event could
17 happen that would result in a downgrade. . . .”); Higgins Testimony at 279:3-18 (“In
18 my view, it is allowing the FFO/Debt ratio to go – not taking any steps to prevent it
19 from going below 18% would be taking an undue risk that the credit rating of the
20 Company would be downgraded.”). In fact, in light of the evidence presented in the
21 case, Staff witness Parcell concluded that he was unable to state that APS is not
22 presently at “substantial” risk of a credit ratings downgrade, and indicated that there
23 are “several uncertainties” on “several important questions” (such as the impact of the
24 current financial crisis on APS’s rating prospects) that make the risk of downgrade a
25 distinct possibility. *See* Parcell Testimony at 895:11-24, 897:12-898:10, 908:18-24.

1 Neither was there dispute regarding the serious negative impacts to APS and its
2 customers should the Company's bond ratings be downgraded. If a ratings
3 downgrade occurred, APS's financing costs would increase by roughly \$1 billion over
4 the next ten years and its access to financial capital could be severely limited. *See,*
5 *e.g., Higgins Testimony at 248:18-250:9; Brandt Testimony at 439:1-16; Smith*
6 *Testimony at 683:115-684:20.* Such consequences would clearly jeopardize APS's
7 ability to meet even its basic service obligations and prevent the Company from
8 making the necessary investments that will allow the Company to set the stage for a
9 more sustainable energy future for our State. Residential Utility Consumer Office
10 ("RUCO") Director Steven Ahearn testified that, for these reasons, a downgrade to
11 junk would be "very bad," with consequences that are not only "exceptionally
12 detrimental" for customers, but that would endure over the long-term. *See Ahearn*
13 *Testimony at 1064:1-16.* AECC Witness Kevin Higgins – a witness representing a
14 number of APS commercial and industrial customers – agreed, expressly testifying
15 that granting APS the relief requested in order to avoid such consequences would be
16 "reasonable," "warranted," "prudent," and "required," and that failing to grant interim
17 relief, if not outright imprudent, in his opinion would nonetheless "not be the best
18 decision." *See Higgins Testimony at 248:18-250:9.*

19 Also, granting APS the requested interim relief would undeniably send a
20 positive message to the financial community that the Commission both is concerned
21 about and is taking proactive measures to protect the Company's financial health – a
22 message that could well prevent the risk of downgrade, and the undisputed and
23 catastrophic consequences of such an event, from materializing. *See Brandt*
24 *Testimony at 504:5-11; Smith Testimony at 690:6-9.* A roughly four mil increase
25 that, if not later found supportable in the permanent rate case, is fully refundable with
26 interest to customers at the close of the general rate proceedings is relatively

1 inexpensive insurance against such a risk. In fact, Mr. Ahearn testified that, as an
2 advocate for consumers, a belief that just a **25 percent chance** that a downgrade
3 would occur absent interim rate relief would cause him to “seek an option to reduce
4 the likelihood of the event occurring.” See Ahearn Testimony at 1073:11-25.
5 Significantly, Mr. Ahearn also testified that his opinion as to whether or not the
6 Company’s current risk of downgrade could be characterized as an emergency “might
7 well be different” if he were a Commissioner instead of merely an advocate for
8 particular customers. See *id.* at 1084:1-8.

9 As discussed further below, the interim relief that APS is seeking is
10 permissible under both well-established law and the Commission’s own articulated
11 standards. The Commission’s broad authority allows it to grant interim relief under
12 the circumstances facing APS even absent an explicit finding of an “emergency” and
13 despite the inability to conduct a full fair-value analysis until the pending general rate
14 case. In any event, APS’s current financial crisis and the attendant risk of a bond
15 rating downgrade clearly constitutes an emergency and supports interim relief under
16 any potentially applicable “emergency” standard.

17 Anticipating that the Commission will address more comprehensively many of
18 the problems facing APS during its general rate case, APS is seeking in this interim
19 proceeding only the relief that it believes is minimally necessary to preserve its
20 financial viability and stave off a credit ratings downgrade until a final decision in the
21 general rate case. And, besides shielding customers from the harmful long-term
22 impact of a downgrade to junk status, the Commission now has the opportunity to
23 grant the necessary interim relief in a way that will moderate the effect on customers,
24 more accurately reflect the true costs of service, and reduce the rate impact upon the
25 conclusion of the general rate case.

1 **I. THE COMMISSION HAS AUTHORITY TO GRANT INTERIM**
2 **RELIEF UNDER THE CIRCUMSTANCES FACING APS.**

3 **A. No Finding of an “Emergency” Is Necessary.**

4 Under Arizona law, the Commission clearly has the requisite authority to grant
5 interim relief to APS based on the facts established at the hearing. As an initial
6 matter, the Commission need not determine whether an “emergency” currently exists
7 to grant interim relief, despite arguments to the contrary by both Commission Staff
8 and RUCO.

9 Established authorities and the Commission’s own precedent make clear that
10 the Commission has broad power to fashion and grant appropriate rate relief
11 depending on the particular circumstances facing a utility. The Arizona Constitution
12 provides the Commission with the “full power to . . . prescribe just and reasonable
13 classifications to be used and just and reasonable rates and charges to be made and
14 collected, by public service corporations within the State for services rendered
15 therein.” Ariz. Const., art. 15, § 3. As the Attorney General has noted in discussing
16 the Commission’s authority, “the Commission’s powers are not limited to those
17 expressly granted by the Constitution; the Commission may exercise all powers
18 necessary or essential in the performance of its duties.” Op. Att’y Gen. 71-17 at 2-3
19 (citing *Garvey v. Trew*, 64 Ariz. 342, 346, 170 P.2d 845, 848 (1946)); *see also* Ariz.
20 *Corp. Comm’n v. Super. Ct.*, 107 Ariz. 24, 26, 480 P.2d 988, 990 (1971) (“[N]o other
21 state has given its commission the extensive power and jurisdiction that the Arizona
22 Corporation Commission possesses.”).

23 In light of the Commission’s broad grant of authority to award a utility all
24 appropriate rate relief, Arizona courts have held that the Commission may award
25 interim relief in a variety of circumstances, even without any express finding that an
26 emergency exists. In *Pueblo Del Sol Water Co. v. Ariz. Corp. Comm.*, 160 Ariz. 285,

1 772 P.2d 1138 (App. 1988), for example, the Court of Appeals held that the
2 Commission's inability to conduct a general rate review in a reasonable time was
3 sufficient to justify interim relief, even absent a finding of an emergency. In fact, the
4 Court stated expressly that "[i]nterim rates are not limited to emergency situations."
5 *See id.* at 287, 772 P.2d at 1140.² The Arizona Supreme Court also has upheld a
6 utility's right to interim relief where the Commission's normal ratemaking process
7 would not be completed in a reasonable time. *See Ariz. Corp. Comm'n v. Mountain*
8 *States Tel. & Tel. Co.*, 71 Ariz. 404, 228 P.2d 749 (1951). In that case, the Court did
9 not discuss, let alone reach a decision regarding, whether any "emergency" existed to
10 justify the relief.

11 Consistent with such decisions, the Commission itself has found that interim
12 rate relief is an appropriate response to problems facing utilities, regardless of
13 whether such problems can be characterized as "emergencies." For example, the
14 Commission authorized interim rate relief without finding the existence of an
15 emergency in connection with Tucson Electric Power's recent request to continue an
16 expiring surcharge in Decision No. 69568 (May 21, 2007). In that case, even without
17 an explicit finding of an emergency, the Commission found as sufficient justification
18 for an interim rate increase the ability to minimize negative effects on the utility's
19 finances while avoiding a "yo-yo" rate impact. *See* Decision No. 69568 at 16, 20.

20 Nor is this conclusion inconsistent with the Commission's 2006 decision
21 granting APS interim relief. In Decision No. 68685 (May 5, 2006), the Commission
22 held that it did not need to find the existence of an emergency to award interim relief,
23 and remedied APS's need for increased revenue on an interim basis through the

24 ² While Division 2 of the Court of Appeals issued the *Pueblo Del Sol* opinion, Division 1 reached a
25 conflicting conclusion in *Residential Util. Consumer Office v. Ariz. Corp. Comm.*, 199 Ariz. 588, 592,
26 20 P.3d 1169, 1173 (App. 2001), holding that an emergency was required to grant interim relief. As
discussed below, however, even if Division 1's articulated standard was appropriate – and there is
significant contrary authority – APS unquestionably would be entitled to relief in the instant case.

1 previously established PSA mechanism. *See* Decision No. 68685 (“Although we find
2 that an ‘emergency’ does not exist, we do agree that some action should be taken to
3 insure more timely recovery of APS’ prudent fuel and purchased power costs.”).

4 **B. Arizona Attorney General Opinion 71-17 Is Not to the Contrary.**

5 Attorney General Opinion 71-17 – the authority relied upon by Staff and
6 RUCO in this proceeding – is not to the contrary. While not binding on this
7 Commission or any court, that Opinion emphasized the wide scope of the
8 Commission’s authority, explaining that “the Commission’s broad and exclusive
9 legislative power to choose the modes by which it establishes rates should be
10 construed broadly enough to permit the Commission to avail itself of concepts and
11 procedures which are devised from time to time to permit effective utility regulation
12 **and to keep pace with constantly changing economic and social conditions.”** Op.
13 Att’y Gen. 71-17 at 3 (internal quotation marks and citation omitted; emphasis
14 added). The Opinion then went on to cite as authority various regulatory jurisdictions
15 outside of Arizona (including both rate-making bodies and courts) that had approved
16 interim rates in order to meet this end. *See id.* at 5-20.

17 Indeed, such other regulatory jurisdictions have concluded that interim rates or
18 other mechanisms are appropriate and routinely implement such procedures without
19 first defining or establishing the existence of an emergency or similar prerequisite to
20 an award, and often based on concerns over a utility’s continuing financial viability.
21 *See, e.g.,* Interim Decision & Order No. 6680-UR-114 (Pub. Serv. Comm’n of Wis.,
22 December 6, 2005) at 7 (extraordinary fuel costs justified interim relief even absent
23 showing of emergency); Opinion & Order, Regulatory Comm’n of Alaska, 2005 Alas.
24 PUC LEXIS 405 (Oct. 6, 2005) at *19-20 (interim relief available where rates were
25 confiscatorily low, inadequate rates would remain in effect for unreasonably long
26

1 time, increase was subject to refund, and utility could not recover revenue deficiency
2 absent interim relief).

3 Moreover, the Attorney General's Opinion is not clear that a finding of actual
4 "emergency" must be made in this case to grant interim relief. In fact, the Opinion
5 should be reasonably interpreted as **not** imposing such a prerequisite where, as here,
6 an evidentiary hearing has been conducted. Although the Opinion stated generally
7 that a finding of an emergency is necessary to award interim relief, its discussion of
8 the issue appears to limit that statement to *ex parte* interim rate proceedings
9 conducted without a hearing, thus implying that such a finding is *not* required if all
10 interested parties are given notice and an opportunity to be heard prior to the
11 implementation of such rates, as has occurred here. *See* Op. Att'y Gen. 71-17 at 8
12 ("[I]f interim rate relief is granted in non-emergency situations, we anticipate that
13 courts may find the corporation's need for rate relief is not paramount to the
14 consumers' right to notice and opportunity to be heard"), *id.* at 11 ("It would be
15 contrary to this policy [regarding consumers' right to notice and opportunity to be
16 heard] for the Commission to grant interim rates *ex parte*, without first finding the
17 existence of an emergency.").

18 In any case, what constitutes an "emergency" under the Attorney General
19 opinion is decidedly broad, and is not limited to one of three narrow circumstances –
20 insolvency, a sudden change, or a threat to the utility's ability to maintain service – as
21 some parties have appeared to suggest. In fact, RUCO's witness agreed that, in citing
22 these circumstances as those that would constitute an emergency, the Attorney
23 General did not purport to give an "all-inclusive" list of emergency situations. *See*
24 Ahearn Testimony at 1069:17-1072:3. To the contrary, while discussing
25 circumstances that have justified interim relief in other jurisdictions, the Attorney
26 General neither limited the granting of interim relief to any specific situations nor

1 otherwise found that any specific condition was a necessary predicate for interim
2 relief. Quite the opposite: he expressly concluded that “[p]erhaps the **only** valid
3 generalization on this subject [of what circumstances justify interim relief] is that
4 interim rate relief is **not** proper merely because a company’s rate of return has, over a
5 period of time, deteriorated to the point that it is unreasonably low. **In other words,**
6 **interim rate relief should not be made available to enable a public service**
7 **corporation to ignore its obligations to be aware of its earnings position at all**
8 **times and to make timely application for rate relief, thus preserving its ability to**
9 **render adequate service and to pay a reasonable return to its investors.”** See Op.
10 Att’y Gen. at 13 (emphasis added). Interim relief surely cannot be denied APS on
11 those grounds. Indeed, based on *Mountain States*, the Attorney General expressly
12 concluded that “the inability of the Commission to grant permanent rate relief within
13 a reasonable time would be grounds for granting interim relief.” *Id.*

14 Despite its reliance on Opinion 71-17, Staff, through its expert, acknowledged
15 that the Commission may grant interim relief without a finding of an emergency.
16 Staff witness Mr. Smith testified that interim relief was warranted not only when an
17 emergency existed, but also when “the Commission is unable to process a utility’s
18 base rate increase request in a timely manner” or “**if other special circumstances are**
19 **present.”** Smith Direct Testimony (Staff Exhibit 1) at 8 (emphasis added). Other
20 parties’ witnesses concurred. See, e.g., Higgins Testimony at 284:10-17 (“It is not
21 necessary for there to be a finding of emergency for an interim increase to be
22 awarded.”).

23 **C. The Commission Has Broad Authority to Conclude that an**
24 **“Emergency” Exists in This Case.**

25 Even if the Commission were to adopt the view that it must find that an
26 emergency exists before approving interim relief, it repeatedly has construed its

1 authority as broad enough to consider all relevant circumstances in making such a
2 finding and has declined to find any particular fact or condition dispositive in
3 reaching a decision. *See* Decision No. 68685 at 23 (“[O]ur authority to determine
4 emergencies is not limited to specific, narrowly tailored facts, and . . . our ratemaking
5 authority is sufficiently broad to enable us to grant relief tailored to many different
6 situations.”). In this matter too, Mr. Smith verified that, in Staff’s opinion, “what
7 qualifies as an emergency is largely an issue of fact for the Commission to decide.”
8 Smith Direct Testimony (Staff Exhibit 1) at 10.

9 Among the factors that the Commission has found relevant in granting interim
10 relief in the past were poor earnings, financing difficulties, and threats of a rating
11 downgrade. For example, in Decision No. 53909 (January 30, 1984), the Commission
12 approved APS’s application for interim relief to prevent a threatened credit-rating
13 downgrade. Upon a review of the Company’s financial metrics, the Commission
14 concluded that “APS’s commercial paper rating may be downrated absent significant
15 interim rate relief, thus necessitating massive borrowing under bank lines of credit at
16 higher interest rates and further exacerbating APS’s declining coverage ratios.” *Id.* at
17 5. The Commission further noted that absent improvement of APS’s financial
18 metrics, its long-term bond rating (then BBB+, as opposed to the far more precarious
19 BBB- that APS holds today) also was threatened, and that a downgrade of that rating
20 would “cost APS and its customers millions of dollars annually for increased interest
21 expense and will require a correspondingly greater increase in revenues to provide
22 even the minimal coverage ratios associated with that speculative grade of security.”
23 *Id.*; *see also Re Ariz. Water Co.*, Decision No. 53349 (December 21, 1982) at 7
24 (granting interim relief based on utility’s prospects of losing tax benefits). Indeed, in
25 the six instances of interim relief between 1975 and 1986 cited by Mr. Post in his
26 testimony (*see* Post Testimony at 799:1-9), **none** of the Commission decisions found

1 the specific examples of an “emergency” given in Attorney General Opinion 71-17 to
2 have been the basis for the Commission’s grant of interim rates. *See* Decision Nos.
3 44920 (January 16, 1975), 47359 (September 30, 1976), 48569 (January 4, 1978),
4 51753 (February 4, 1981), 53909, and 55228 (October 9, 1986).

5 Decisions in other jurisdictions are in accord. *See, e.g.,* Order, Ind. Pub. Serv.
6 Comm’n, 86 WL 732831 (March 7, 1986) at *16 (interim relief warranted where,
7 among other factors, “most traditional financial ratios and measures for [utility] were
8 at greatly deteriorated levels,” “current financial condition is precarious,” common
9 stock was selling below book value, and bonds and stock had fallen below investment
10 grade); *Pub. Serv. Co. of Colo. v. Pub. Util. Comm’n of State of Colo.*, 653 P.2d 1117,
11 1122 (Colo. 1982) (interim relief appropriate where company’s “ability to raise
12 capital was seriously impaired due to decreased earnings and a downgrading of Public
13 Service [Company of Colorado]’s rating by both Moody’s and Standard & Poor’s”);
14 Opinion & Interim Order, Ill. Commerce Comm’n, 49 P.U.R.4th 62, 76 (May 6,
15 1982) at 10 (absent interim relief, current financial situation threatened utility’s access
16 to capital and “a further downgrading of [utility’s] credit ratings, particularly as to its
17 commercial paper, would immediately restrict [utility’s] day to day financing of all
18 expenditures”); Order No. U-14690-A, La. Pub. Serv. Comm’n, 1981 La. PUC
19 LEXIS 213 (May 26, 1981) at *2 (approving interim relief where “[i]n attempting to
20 finance its construction program, [utility] has significantly weakened its financial
21 position” and “capital offerings of the company have been downrated to relatively low
22 standing by the rating agencies.”).

23 Thus, it is clear that the Commission has authority to grant the interim relief
24 that APS seeks and that the existence of such authority is not dependent on any
25 finding of a “sudden or unanticipated circumstance affecting [APS’s] ability to offer
26 reliable electric service,” a “crisis” that “had already occurred or was occurring,” or

1 any other specific circumstance or set of circumstances that other parties may be
2 characterize as an “emergency.” Smith Direct Testimony (Staff Exhibit 1) at 10, 15.
3 To the contrary, it is surely within the Commission’s constitutional power and the
4 public interest for the Commission to help a utility prepare for and counter a
5 **threatened** event – such as the credit-rating downgrade now threatening APS and the
6 attendant (and acknowledged) negative impacts of such a consequence on the State’s
7 largest utility and its customers – **before** that event arrives and the damage is
8 irreversible. As a witness in an earlier (1983) APS interim rate proceeding stated, it is
9 an emergency when you fall out the window – not when you hit the ground. In any
10 case, as explained below, there is no question that APS faces a financial emergency
11 and circumstances supporting interim relief under any standard.

12 **D. A Fair-Value Analysis Is Not Required for a Grant of Interim**
13 **Relief.**

14 Given the limited nature of interim relief, the inability to engage in a full fair-
15 value analysis does not preclude the granting of such relief. As Attorney General
16 Opinion 71-17 made clear, “the Corporation Commission need not establish the fair
17 value of the property of a public service corporation prior to establishing interim
18 rates.” Op. Att’y Gen. No. 71-17 at 9; *see also id.* at 10 (“[W]e think the Commission
19 would be ill-advised to make, at the time of an interim rate proceeding, written
20 findings as contemplated in A.R.S. § 40-251 [relating to the value of a public service
21 corporation’s property]. Furthermore, we find no legal requirement that a ‘temporary
22 fair value’ be established prior to the establishment of interim rates.”).

23 In any case, although not legally required, the Commission could, in fact, make
24 such a “temporary” or interim fair value finding here. As discussed later in this brief
25 (and as described in the testimonies of Staff Witness Smith and APS Witnesses
26 Brandt and Rumolo), the subsequent increments to the Company’s 2005 rate base, per

1 Decision No. 69663 (June 28, 2007), are essentially “fair value” rate base increments
2 because original cost and reconstruction cost would be nearly equal. Thus, if believed
3 necessary by the Commission, these incremental plant additions could be added to the
4 fair value rate base found by the Commission in Decision No. 69663. *See infra* at 26-
5 27.

6 **II. APS HAS AN URGENT NEED FOR INTERIM RELIEF UNDER ANY**
7 **APPLICABLE STANDARD.**

8 Regardless of the particular standard applied, APS has established sufficient
9 facts to support its critical need for interim relief. As APS demonstrated during the
10 hearing, it currently is facing a severe financial crisis due to high capital requirements,
11 a ballooning earnings shortfall caused by rates that are below its cost of service, and
12 prolonged regulatory lag in the face of deteriorating market conditions and credit
13 metrics that hover just above junk-bond status and that are trending downward. This
14 is not a matter of fixing blame; it is not a matter of finding fault; it is simply a matter
15 of facing the facts.

16 Far from the “normal” consequences of utility regulation, APS is facing a
17 highly unusual combination of financial pressures in an environment of extraordinary
18 regulatory lag. More specifically, APS’s witnesses and exhibits established (and the
19 other parties did not refute) the following facts underscoring APS’s pressing need for
20 interim relief:

- 21 • Since the end of the test year utilized in the Company’s last rate case,
22 APS has incurred over \$1 billion in capital expenditures, in turn increasing its
23 ACC-jurisdictional rate base by more than \$500 million – plant additions that
24 are not reflected in current rates. *See* Brandt Rebuttal Testimony (APS Exhibit
25 2) at 3; Smith Direct Testimony (Staff Exhibit 1) at 12. Such capital
26 requirements are compounded by skyrocketing commodities costs, foreign-

1 exchange pressures, and the challenging environment in credit and capital
2 markets caused by the current economic crisis. *See* Brandt Rebuttal Testimony
3 (APS Exhibit 2) at 8.

4 • APS's costs have continued to outpace its revenues, resulting in a
5 massive and growing earnings shortfall amounting to over \$300 million in just
6 the past five years. *See id.* at 11.

7 • Due to weak and deteriorating financial metrics, APS's credit ratings
8 have fallen to a level just above junk status, clinging to the lowest level for
9 investment grade under Standard & Poor's rankings (BBB-) and the second-
10 lowest level for investment grade according to Moody's and Fitch's rankings
11 (Baa2 and BBB, respectively). Only a handful of other investor-owned utilities
12 have bond ratings that are worse than those of APS. *See* Brandt Affidavit
13 (APS Exhibit 1) at 11; Parcell Testimony at 955:11-24.

14 • A decline in APS's credit ratings to junk status would have severely
15 detrimental consequences to both the Company and its customers, drastically
16 increasing costs and jeopardizing APS's ability to provide continuing reliable
17 service throughout Arizona. *See, e.g.,* Higgins Testimony at 248:18-250:9;
18 Brandt Testimony at 439:1-16; Smith Testimony at 683:15-684:20.

19 • As its financial performance has continued to decline, Pinnacle West's
20 stock performance is among the worst of all investor-owned public utilities in
21 the country. *See* Brandt Affidavit (APS Exhibit 1) at 8-9; Brandt Rebuttal
22 Testimony (APS Exhibit 2) at 31-33.

23 • Because rates are based on a historical test year, APS's rates also have
24 not kept pace with its costs. Consequently, it frequently takes at least three
25 years from the date a cost is incurred for APS to begin to recover that cost
26

1 through implemented rates. *See* Brandt Testimony at 155:22-157:22; Cicchetti
2 Testimony at 856:8-857:11.

3 • As a result of its continuing inability to recover its properly incurred
4 costs through adequate rates, APS has lacked any opportunity to approach its
5 authorized 10.75 percent rate of return for several years, with actual ACC-
6 jurisdictional returns expected to fall to 6.3 percent in 2009. *See* Brandt
7 Rebuttal Testimony (APS Exhibit 2) at 11.

8 As previously indicated, there is no dispute among the parties that APS faces
9 some risk of a credit-rating downgrade, and that the consequences of such action
10 would be “very bad” for both the Company and its customers. The key issue for the
11 Commission to decide is whether that undisputed risk is sufficient to warrant interim
12 relief. APS firmly believes that in the current credit environment, there is a very high
13 risk that APS will be downgraded to junk status absent some measure of interim rate
14 relief. *See, e.g.,* Brandt Affidavit (APS Exhibit 1) at 4; Brandt Testimony at 438:14-
15 439:16, 502:11-503:13; Cicchetti Testimony at 813:12-20. The downward trend in
16 the Company’s credit metrics, the current uncertainty in financial markets, and the
17 rating agencies’ current views regarding the Company’s need for recovery of costs in
18 a “timely” manner all substantiate this concern.

19 As APS’s witnesses established, the Company’s credit metrics – in particular
20 the key ratio of funds from operations to total debt (“FFO/Debt”) – will fall below
21 required levels to sustain APS at investment grade at some point during 2009, likely
22 before new rates are implemented or have any practical effect. *See* APS Exhibit 6.
23 Despite other parties’ efforts to suggest otherwise, the FFO/Debt ratio is
24 acknowledged and accepted as a key measure of a company’s financial strength and
25 indicator of future financial performance, as the very reports on which Staff relies
26 confirm. *See, e.g.,* S&P’s Corporate Ratings Criteria (2008) (Attached to Staff

1 Exhibit 1 at 40) (“cash flow adequacy is typically the single most critical aspect of
2 credit rating analysis”), *id.* at 42 (FFO/Debt is “the most frequently used credit
3 measure in industrial ratings”). *See also* Brandt Rebuttal Testimony (APS Exhibit 2)
4 at 22-23.

5 Also undisputed is that, under S&P’s methodology, where a utility faces a
6 challenging operational or regulatory environment, such as one with relatively
7 prolonged regulatory lag, rating agencies expect its financial metrics to approach the
8 higher end of the required range. *See* S&P Ratings Direct (November 30, 2007)
9 (RUCO Exhibit 3) at 3 (utility that “falls along the lower end of its business risk
10 designation, would have to demonstrate an ability to achieve financial metrics along
11 the more stringent end of the ratio ranges to reach a given rating.”). For APS, S&P
12 has indicated that, because of the Company’s business risks – in particular, the
13 inability to recover its capital costs on a timely basis – the Company’s FFO/Debt ratio
14 must be at least 18 percent to remain within investment grade (a fact that did not
15 change when S&P began to portray electric utilities in the corporate ratings matrix,
16 which does not specifically spell out “business profiles,” late last year). *See* Brandt
17 Rebuttal Testimony (APS Exhibit 2) at 26-27; Brandt Testimony at 368:11-370:8.
18 Staff Witness Mr. Parcell agrees that, although S&P no longer publishes specific
19 “business profiles,” it is nonetheless clear that the same principles and methodology
20 that applied to electric utilities in the past still apply today. *See* Parcell Testimony at
21 924:13-20.

22 Any suggestion that, in the current market environment (one in which ratings
23 from credit rating agencies are closely scrutinized and for which all such agencies are
24 held closely accountable to the public for their published assessments), S&P would
25 have loosened its financial metric requirements for utilities in order to allow them to
26 achieve higher ratings notwithstanding worsening financial performance is contrary to

1 both reason and the plain language of the published ratings guidance. Rather, both the
2 written documents and the testimony of those who have directly discussed this issue
3 with credit rating agencies make clear that the 18 percent threshold for APS remains
4 firm. *See* Brandt Rebuttal Testimony (APS Exhibit 2) at 26-27; Brandt Testimony at
5 368:11 to 370:8; Higgins Testimony at 288:10-290:2. Even Staff's consultant Mr.
6 Parcell agrees that, to the extent that the new S&P matrix is not used to arrive at a
7 rating by rote, it is important to be sure that the metrics that APS maintains are
8 sufficient to ensure that S&P does not assign APS a rating "one notch below" its
9 current rating, into junk status. *See* Parcell Testimony at 948:13-949:11.

10 Yet, rather than maintaining its financial metrics safely within the investment-
11 grade range, APS faces a continuing decline of those figures, with projections
12 showing that its FFO/Debt ratio would fall to 15.8 percent by the end of 2009 and to
13 15.0 percent in 2010 without rate relief – numbers in the "mid-teens" that are clearly
14 not sufficient to support APS's current BBB- bond rating. *See* APS Exhibits 6 & 22.
15 While Staff makes much of a table purporting to calculate the FFO/Debt ratio under
16 various scenarios, including the denial of interim relief, its analysis is based on
17 fundamentally flawed assumptions. First, Staff assumes that APS will benefit from
18 increased rates as a result of the general rate hearing – with a rate increase between
19 9.5 and 17.5 percent – by October 1, 2009. This assumption ignores the very real
20 possibility that new rates may not be implemented before year-end 2009 or early 2010
21 at best, and the obvious lack of any certainty as to how much of a rate increase APS
22 will eventually receive from the Commission. In addition, Staff's analysis assumes
23 that APS would be able to receive a \$400 million equity infusion in 2008. But, as
24 Staff now acknowledges, such an infusion under current conditions is neither possible
25 nor practical. Unfortunately, rating agencies are unlikely simply to adopt a "wait and
26

1 see” approach or maintain an APS debt rating based on a mere “hope” of future rate
2 relief.

3 Besides establishing the likelihood of a downgrade, APS further demonstrated
4 that the credit rating agencies are keenly aware of the Company’s declining financial
5 metrics and its continuing need for proactive regulatory relief from the Commission.
6 In discussing the Company’s recent “outlooks,” the rating agencies have made clear
7 in their reports that the Commission’s response to the Company’s pending requests
8 for rate relief, including this interim request, will influence rating decisions. *See, e.g.,*
9 S&P’s Ratings Direct (June 25, 2008) (Staff Exhibit 2, attachment 9) at 2-3 (“The use
10 of a historical test year in Arizona, coupled with the fact that fully litigated rate cases
11 take between 18 to 24 months to complete, is expected to result in no meaningful
12 improvement in financial performance through 2009 and possibly beyond, depending
13 on the timing and the outcome of the company’s current case.”), *id.* at 4
14 (“[C]onsolidated financial performance will continue to be challenged by regulatory
15 lag at APS, which could be moderated by APS’s pending interim rate request.”);
16 Moody’s Credit Opinion (July 28, 2008) (Staff Exhibit 2, attachment 6) at 4
17 (“Moody’s notes that the ACC has granted interim increases in the recent past.
18 Moody’s views mechanisms designed to reduce the time required to recover a utility’s
19 costs, such as the requested interim base rate increase a positive for credit quality.”).
20 In fact, as it did prior to the Company’s downgrade to BBB- in December 2005, APS
21 has again learned directly from S&P that S&P intends to decide on any change to
22 APS’s rating through a committee session to be held upon the conclusion of this
23 interim proceeding. *See* Brandt Rebuttal Testimony (APS Exhibit 2) at 26-27; Brandt
24 Testimony at 142:5-143:10, 203:2-22.

25 Furthermore, the Commission cannot assume that the rating agencies will
26 necessarily change APS’s “outlook” or otherwise provide notice of a decision to

1 downgrade ratings before that downgrade occurs. Indeed, the downgrade of APS
2 from BBB to BBB- by S&P on December 21, 2005 took place with no advance
3 warning and no change in the "stable" outlook that S&P had given APS **just five days**
4 **prior to the downgrade.** See APS Exhibits 15 & 16; Parcell Testimony at 949:21-
5 952:6. Like today, APS had a rate case pending at the time it was downgraded by all
6 three rating agencies. See APS Exhibit 16; Parcell Testimony at 952:9-22, 961:4-
7 962:1. Indeed, given the current financial upheaval in the economy and with rating
8 agencies already subject to closer scrutiny under the Credit Rating Agency Reform
9 Act of 2006, 120 Stat. 1327, there is an even greater likelihood of a prompt
10 downgrade if APS's financial metrics continue to decline.

11 The parties do not dispute that if a downgrade occurs, both the Company and
12 its customers would suffer due to higher borrowing costs, limited or foreclosed access
13 to debt and equity markets, and a real risk that the Company would be unable to make
14 required investments and ensure continuing reliable service, let alone provide the
15 customer-beneficial and Commission-endorsed programming that will serve as a
16 foundation for a sustainable energy future for Arizona. Nor do they dispute that both
17 the downgrade and its impact on the Company and ratepayers would take years to
18 remedy. In fact, acknowledging the compelling need to avoid a downgrade, each
19 party concedes that the **threat** of a downgrade, if sufficiently real, would warrant
20 interim relief. See, e.g., Higgins Testimony at 279:3-18; Ahearn Testimony at
21 1073:11-25, 1084:1-8; Smith Testimony at 682:5-24. AECC even agrees, given the
22 existing risk to APS, that interim relief is appropriate, disputing only the necessary
23 amount of such relief. See, e.g., Higgins Testimony at 248:18-250:9. Other parties,
24 while not conceding that interim relief is necessary, testified that customers' best
25 interests are served by ensuring that APS is as far from non-investment grade as
26 possible and that the ultimate goal should thus be an upgrade to a higher investment

1 status. *See, e.g.,* Ahearn Testimony at 1064:1-16; Parcell Testimony at 979:17-980:7;
2 Cicchetti Testimony at 810:11-18. Significantly, not a single party was willing or
3 able to testify that a downgrade would **not** occur absent interim relief. *See, e.g.,*
4 Ahearn Testimony at 1064:25-1065:2; Smith Testimony at 630:2-14; Higgins
5 Testimony at 279:3-18; Parcell Testimony at 895:11-24, 897:12-898:10, 908:18-24.

6 In stark contrast to the impact of a downgrade on customers, the practical effect
7 of an interim award would be low, imposing a relatively modest rate increase that
8 would help recover legitimate costs of service beginning at a time when customers
9 will be experiencing lower winter rates in November. Interim relief would also allow
10 a more gradual phasing-in of any future permanent increase, and be subject to a
11 refund with interest if APS were unable to support that level of relief in the general
12 rate case. Simply hoping that permanent rate relief will arrive in time to prevent a
13 rating downgrade – thus gambling with the viability of the Company’s finances and
14 the State’s energy future – would be, in APS’s opinion, contrary to the public interest.
15 Given the extraordinary circumstances facing APS, the relatively modest impact of a
16 rate increase on customers, and the undeniably harmful consequences of a downgrade,
17 the Commission should grant the Company’s request and award it the interim relief
18 that it seeks.

1 **III. APS'S REQUESTED INCREASE OF \$115 MILLION IS AN**
2 **APPROPRIATE AMOUNT OF INTERIM RELIEF UNDER THE**
3 **CIRCUMSTANCES.**

4 The evidence is thus compelling that some level of interim relief is necessary
5 to prevent a downgrade of APS's credit ratings and allow the Company the ability to
6 continue to implement its vision of providing sustainable, reliable service to its
7 customers at reasonable prices. Precisely what amount of relief will be sufficient to
8 send a message to the market that the Commission is committed to protecting the
9 Company's financial health, however, is unknown (and, indeed, is unknowable in
10 advance). Through its requested increase of \$115 million, APS seeks what it believes
11 is a reasonable level of interim protection to shield itself from a downgrade pending
12 the conclusion of the Company's general rate case.

13 The Company's requested \$115 million annual revenue increase will raise its
14 FFO/Debt level from 15.8 percent (under present rates) to 17.6 percent by year-end
15 2009. *See* APS Exhibits 6 and 21. This FFO/Debt percentage can increase by, at
16 best, roughly 0.6 percent to 1.0 percent by year-end 2009 as a result of the Company's
17 anticipated capital expenditure reductions (an estimate that does not include the
18 negative impact of decreasing revenues caused by slowing sales growth and lower
19 TCA revenues). *See* Brandt Testimony at 488:15-22; APS Exhibit 22. Although
20 providing only a slight cushion against unanticipated events, APS's requested
21 increase will nevertheless permit the Company's FFO/Debt ratio to remain roughly
22 within investment grade through year end 2009. More importantly, however, the
23 message sent to the investment community if the Commission grants such an increase
24 will provide needed assurance to the rating agencies regarding both the Company's
25 future financial condition and this Commission's recognition of the critical need to
26 address that financial condition in a timely fashion. *See, e.g.,* Brandt Testimony at
502:11-504:11.

1 The alternative levels of relief proposed by Staff's consultants and the AECC
2 do not achieve this important goal. Indeed, although AECC expert witness Kevin
3 Higgins testified that he believed the Company's current circumstances warranted an
4 interim increase sufficient to allow APS to achieve an 18.25 percent FFO/Debt ratio
5 through year end 2009 (the minimum 18 percent threshold plus a reasonable
6 "buffer"), his proposed \$45 million increase assumed that the Company would be able
7 to benefit from a \$400 million equity infusion from Pinnacle West. Without such an
8 infusion, Mr. Higgins's proposal would result in an FFO/Debt ratio of only 16.4
9 percent by year end 2009 – well into "junk" range. *See* APS Exhibit 9. In fact, the
10 evidence shows that a revenue requirement increase of \$166.4 million annually is the
11 minimum amount necessary to allow APS to maintain an FFO/Debt ratio of 18.25
12 percent while the general rate case is processed. *See id.* Staff's proposed \$65 million
13 interim increase similarly results in an FFO/Debt ratio that falls well below the 18
14 percent threshold, at roughly 16.7 percent. *See* Brandt Testimony at 83:16-84:8.
15 Compared to the Company's request, these alternative proposals result in a
16 "substantially greater risk" that APS will be downgraded *before* the general rate case
17 is concluded, as it was by S&P in 2005 and Moody's and Fitch shortly thereafter in
18 2006. *See id.* at 503:17-22, 589:10-590:2.

19 Moreover, the Company's \$115 million request is a moderate one that is easily
20 justified under a conservative estimate of what ongoing costs it is likely to recover in
21 the general rate case. In his alternative recommendation, Staff's consultant, Mr.
22 Smith, proposes granting the Company a \$65 million annual rate increase based on
23 what he describes as a "non-controversial" analysis that considers the change in the
24 Company's rate base from the Company's last rate case (with a Test Year ending
25 September 30, 2005) to its current rate filing (with a Test Year ending December 31,
26 2007) and applies the cost of capital authorized by this Commission in Decision No.

1 69663. *See, e.g.*, Smith Testimony at 619:3-14, 677:18-25. This approach, Mr. Smith
2 explained at the hearing, was intended to “tie an amount of interim rate increase to
3 something tangible in the rate case that’s benefiting ratepayers” and “that seems to be
4 pretty consistent with how – with the Commission’s rate making policies.” *See id.* at
5 677:15-21.

6 APS agrees that, for the purposes of a “non-controversial” calculation of what
7 amount APS might be granted as interim relief, one could focus on changes to rate
8 base resulting from the Company’s capital projects that are now completed and in
9 service benefiting customers. But under such an analysis, an amount greater than Mr.
10 Smith’s proposed \$65 million is clearly supportable. As an initial matter, although
11 Mr. Smith acknowledged that APS’s rate base increased by \$538 million from
12 September 30, 2005 to December 31, 2007, his proposal does not account for the fact
13 that those plant additions – now in service and benefiting customers – are being
14 depreciated as a simple matter of accounting, “no ifs, ands, or buts” (Brandt
15 Testimony at 500:5-7) – a point that Mr. Smith concedes (*see* Smith Testimony at
16 678:16-19). Although Mr. Smith expressed concern about including depreciation
17 expense because it appears on the Company’s income statement (which, according to
18 Mr. Smith, Staff has not yet examined), it does not follow that including the rate base
19 impact of depreciation expense for present purposes would “potentially get into
20 controversial areas that are going to be addressed in the rate case” simply because
21 controversies may later arise regarding **other** items on the Company’s income
22 statement. *Id.* at 678:12-15. APS does not ask the Commission to include all income
23 statement impacts associated with these “non-controversial” plant additions. But
24 including depreciation expense, so that both the return “of” and return “on” the plant
25 additions is acknowledged, is still a conservative approach to analyzing these items.
26 Other expenses associated with the plant, such as increased O&M expense, would at

1 the very least offset any unidentified income statement reductions and can be more
2 appropriately addressed in the general rate case.

3 Failing to include depreciation expense deprives APS of any return “of” its
4 investment, thus preventing the Company from recovering the principal it has already
5 invested in the capital projects underlying Mr. Smith’s accepted change in rate base.
6 And, as Dr. Cicchetti explained, the Company’s recovery “of” the original cost of
7 plant additions is “the regulatory approach used to collect cash flow that can finance
8 replacements and new investments from internal operations.” *See* Cicchetti Rebuttal
9 (APS Exhibit 13) Testimony at 5. Omitting from the revenue requirement calculation
10 the impact of depreciation expense therefore deprives the Company of a needed, and
11 relatively inexpensive, source of funding for future capital projects – a key concern
12 given APS’s massive capital spending obligations and the current condition of the
13 credit markets. The only possible area of disagreement with respect to depreciation
14 expense is what rate should apply, and – for present purposes – APS applied the
15 average depreciation rate that existed in the Test Year, based on depreciation rates
16 approved by the Commission in Decision 69663 (just as Mr. Smith applied to the
17 Company’s change in rate base the cost of capital approved in the same decision).
18 Adding only the impact of depreciation expense on rate base to the \$65 million annual
19 revenue increase proposed by Staff results in an interim increase of **\$95 million**
20 annually. *See* APS Exhibit 10; Brandt Rebuttal Testimony (APS Exhibit 2) at 39.

21 Mr. Smith’s principle that the revenue requirement allowed in this interim case
22 should be based on “something tangible in the rate case that’s benefiting ratepayers”
23 and that is “consistent with the Commission’s policies” also justifies looking beyond
24 the end of the December 31, 2007 Test Year and including in rate base certain post-
25 test year items that are already in service and benefiting customers, as the
26 Commission has done for APS in the past. *See, e.g.,* Decision No. 48319 (August 1,

1 1977); Decision No. 51009 (May 29, 1980); Decision No. 54204 (October 11, 1984);
2 and Decision No. 54247 (November 28, 1984). As APS Exhibit 10 shows, by year-
3 end 2008, APS will have completed and placed in service an additional \$838 million
4 of ACC-jurisdictional plant, bringing its cumulative annualized revenue requirement
5 increase to **\$167 million** using Staff's methodology and including the impact of
6 depreciation expense. *See also* Brandt Testimony at 608:10-14. At least **\$120**
7 **million** of that 2008 cumulative amount is based on **actual** expenditures (not
8 projections) for plant that is already in service and incurring depreciation and is thus
9 easily "known and measurable." *See id.* at 500:8-501:5, 508:20-509:4.

10 By 2009, the Company will have made a cumulative \$907 million dollars in
11 gross ACC-jurisdictional plant additions (plant that will be in service benefiting
12 customers before new rates in the general rate case will take effect), thus bringing the
13 Company's annual revenue requirement increase to a cumulative total of **\$247 million**
14 – an amount that more than doubles the Company's requested \$115 million level of
15 relief. *See* APS Exhibit 10; Brandt Rebuttal Testimony (APS Exhibit 2) at 39. Each
16 of these amounts focuses solely on plant additions and has nothing to do with the
17 Company's operating expenses. *See* Brandt Testimony at 511:4-7. As graphically
18 demonstrated in APS Exhibit 10, the Company's requested \$115 million interim rate
19 level falls on the low end of these clearly justifiable parameters.

20 Another way to build on Mr. Smith's proposal in a similarly "non-
21 controversial" manner is to add to the \$538 million change in rate base past the
22 December 31, 2007 Test Year only certain discrete items, such as the Palo Verde Unit
23 3 steam generator upgrade, the two new Yucca combustion turbine generator units in
24 Yuma, and APS's share of the environmental construction upgrades at Cholla Power
25 Plant – items similar if not identical to others that the Commission has previously
26 found to be recoverable for APS although not placed in service until after the Test

1 Year. Including in rate base the Palo Verde Unit 3 steam generator upgrade, for
2 example, which was placed in service in January of 2008 (the month after the Test
3 Year), is fully consistent with past Commission precedent. Indeed, in APS's last two
4 rate cases, the Commission approved the inclusion of Palo Verde steam generators for
5 Units 1 and 2, each of which was placed in service outside the test year – the precise
6 circumstances presented here. *See* Rumolo Testimony at 1031:20-1033:2. *See also*
7 Decision Nos. 67744 (April 7, 2005) (including in rate base costs associated with the
8 Palo Verde Unit 2 steam generator replacement) and 69663 (including in rate base
9 costs associated with the Palo Verde Unit 1 steam generator replacement).

10 Similarly, the addition in rate base of the Yucca combustion generator units
11 (placed in service in June of 2008) is fully analogous to the inclusion of the Sundance
12 units in the last rate case, which plant the Commission authorized for recovery
13 without controversy although acquired and placed in service by APS after the test
14 year. *See* Decision No. 69663. The Yuma additions are analogous to Sundance and
15 should be relatively non-controversial because they had been (1) authorized for
16 construction by the Commission, and (2) built to serve Yuma, a load pocket with
17 transmission constraints, thus increasing the need for generation resources. *See*
18 Rumolo Testimony at 1033:3-23. Finally, the expenditures at APS's Cholla Power
19 Plant (placed in service in March and May of 2008) are environmental upgrades,
20 which generally receive more favorable and less controversial rate base treatment by
21 the Commission. *See id.* at 1033:24-1034:7.

22 Including in rate base these three discrete projects, each of which has already
23 been completed and is serving customers, is thus consistent with past Commission
24 practice and is likely to be "non-controversial." Moreover, the amounts underlying
25 each of these pro forma adjustments are based on original costs, which is generally
26 the same as fair value for ratemaking purposes with respect to new facilities such as

1 these (for which there is little difference between the plant's original cost and its
2 reconstruction cost). *Id.* at 1034:14-1035:3. Including these additional items in rate
3 base brings the Company's annual revenue requirement increase to **\$118.4 million** –
4 again, above the Company's \$115 million request. *See* Rumolo Rebuttal Testimony
5 (APS Exhibit 19) at 5.

6 Thus, of the various alternatives proposed by the parties, approving the
7 Company's request for an interim rate increase of at least \$115 million is most
8 reasonable to ensure that the Company does not suffer further damage to its financial
9 condition pending the resolution of the general rate case, and is on the moderate side
10 of what could be justified by a "non-controversial" calculation of what the Company
11 is likely to recover in the general rate case. Such amount also should minimize the
12 impact on customers (who until August were paying a nearly identical interim PSA
13 charge), more accurately reflect the true costs of electric service on a current basis
14 (thus sending appropriate price signals to customers), and best phase in the impact to
15 customers of any final rate increase determined by the Commission in the general rate
16 case.

17 **IV. AS ACKNOWLEDGED BY STAFF, CONDITIONING INTERIM**
18 **RELIEF ON AN EQUITY INFUSION BY PINNACLE WEST IS NOT**
APPROPRIATE.

19 Finally, as confirmed by Staff during the hearing, no award of interim relief
20 should be tied to or conditioned upon the proposed \$400 million equity infusion
21 previously approved by the Commission. As the evidence at the hearing made clear,
22 Pinnacle West could not currently issue equity given current market conditions, nor
23 should it attempt to – particularly given the fact that its stock price has fallen below
24 book value. *See, e.g.,* Brandt Rebuttal Testimony (APS Exhibit 2) at 4, 31-33.

1 Mr. Smith's statements on the stand describing Staff's rationale for
2 withdrawing its recommendation that interim relief be conditioned upon an equity
3 issuance articulate well why such a condition would not be appropriate:

4 Staff has listened very carefully to all of the testimony about the
5 equity issuance, and we believe that the link between the granting
6 of interim relief and the equity issuance shouldn't be there.

6 ***

7 We think the Company should be allowed the flexibility to make
8 the equity issuance or to finance capital additions using a mixture
9 of debt and equity. And that decision should be the prerogative
10 of management based on when they believe the conditions are
11 most propitious, and they should be able to evaluate the form of
12 financing that should be used. And also, as Mr. Brandt has
alluded to, over the past few days there's been a substantial
amount of turmoil in the market It's just a very uncertain
time in the market. So we don't think that they should be
pressured into making this equity issuance at this juncture.

13 Smith Testimony at 615:21-24, 623:4-20.

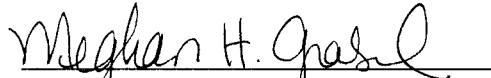
14 As it has done in the past, APS will continue to evaluate all financing options,
15 whether through internal financing, debt, or equity, and will continue to act in the best
16 long-term interests of both itself and its customers.

17 CONCLUSION

18 APS is seeking interim relief only because it believes that intervention by the
19 Commission is necessary to prevent a downgrade of its credit ratings to junk status
20 and the resultant long-term harm to the Company, its customers, and the State's
21 energy future. The severe financial challenges facing APS are undisputed, the
22 potential consequences of inaction are well-established, and the opportunity to act in
23 the best interests of the Company and its customers is within the scope of both the
24 Commission's legal authority and its Constitutional responsibility. Accordingly, APS
25 respectfully requests that the Commission grant its motion and approve the requested
26 interim increase in rates pending the conclusion of its general rate case.

1 RESPECTFULLY SUBMITTED this 3rd day of October 2008.

2 PINNACLE WEST CAPITAL CORP.
3 Law Department

4 
5 Thomas L. Mumaw
6 Meghan H. Grabel

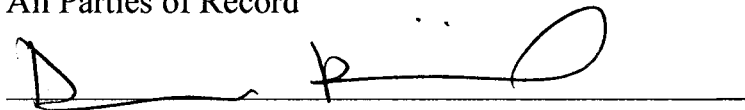
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8
9 ORIGINAL AND 13 COPIES OF THE FOREGOING
10 filed this 3rd day of October 2008 with:

11 Docket Control
12 Arizona Corporation Commission
13 1200 West Washington
14 PHOENIX, AZ 85007

15 AND copies of the foregoing e-mailed or mailed
16 this 3rd day of October 2008 to:

17 All Parties of Record

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